

M. PROCEDURES IN ISSUING ADVERSE STATUS LETTERS

1. Introduction

This paper briefly discusses the steps the Internal Revenue Service follows when it issues adverse letters on an entity's exempt status, its foundation status, or its operating foundation status. Generally, the Service issues adverse letters where it is revoking a letter recognizing an organization as an organization described in IRC 501(c), as a public charity described in IRC 509, or as an operating foundation described in IRC 4942(j)(3). It also issues adverse letters where an organization has never had its status recognized by the Service and an examination indicates that the organization is not exempt, is not a public charity or, is not an operating foundation. There are several other specialized status letters, such as a determination that an organization is not a pooled income fund, but these letters are not discussed in this paper.

2. General

Where an examination indicates that revocation of an organization's ruling or determination letter is appropriate, a proposed revocation letter will be issued. That letter will include the following:

- a. a statement of the material facts upon which the proposed ruling or determination is based;
- b. the applicable statute, regulations, and other governing precedents;
- c. the Service's proposed conclusion and a clear statement of the underlying reasoning for that conclusion;
- d. the proposed effective date of the action;
- e. the organization's right to protest the proposed action by submitting within 30 days, a statement of the facts, law, and arguments in support of continued exemption;
- f. the organization's right to an Appeals office conference (the organization should be advised to indicate whether such

conference is desired. The conference may be held in the District office convenient to both parties);

- g. a copy of Publication 892, Exempt Organizations Appeals Procedures for Unagreed Cases;
- h. in the case of a proposed revocation under IRC 501(c)(3), a statement that if the proposed determination becomes final, appropriate state officials will be advised of the action in accordance with IRC 6104(c) and applicable regulations;
- i. in the case of a proposed adverse letter under IRC 501(c)(3), 509(a) or 4942(j)(3), pattern paragraph P-550 (Rev. 9-77) will be included. P-550 contains language explaining the organization's declaratory judgment rights;
- j. in cases not subject to IRC 7428, a statement that if the organization fails to file a protest letter within the allotted time, the proposed letter will become a final adverse determination. In cases subject to IRC 7428, a final adverse letter must be issued when the case is closed;
- k. if the organization has its exempt status under IRC 501(c)(3) revoked and is still a private foundation, a statement that it will continue to be subject to the provisions of Chapter 42 of the Code unless it terminates its status under IRC 507.

It should be noted that where the adverse action was made on the basis of National Office technical advice, the organization may not appeal the determination and in these cases, a final adverse letter will be sent to the organization.

3. Procedures for Agreed Cases

If an organization's exemption is revoked, the specialist will request the organization to furnish the appropriate return or returns for a taxable organization. These returns are as follows:

- a. Form 1120 for corporations that were formerly recognized exempt under IRC 501(c) or that have been determined to be organizations not described in IRC 501(c);
- b. if a trust was formerly described in IRC 501(c)(3) it may now be an IRC 4947(a)(1) trust and the appropriate returns should be secured. See Part Two of this publication, Current Developments, section I. A. 4, which contains a chart outlining the filing requirements. If a trust is not described in IRC 501(c)(3), a Form 1041 should be obtained.

Revocation of exemption under IRC 501(c)(3) may trigger a filing requirement of employment tax returns, Forms 940 and 941. When all the returns are received, the specialist will forward them to the appropriate service center for processing. In the event a return is not submitted, the specialist will prepare Form 5666, EP/EO Information Report, indicating that the tax return(s) was solicited but not received from the organization.

In all revocation cases, Form 5666 is prepared by the office proposing the action and is submitted along with the case file to the Appeals office, should the case be submitted to Appeals.

Form 5666 will recommend examination for either the first year in which the organization may be a taxable entity, or for an appropriate subsequent year. Information submitted with Form 5666 will include the following:

- a. a statement that the organization's exemption has been revoked;
- b. the effective date of the revocation;
- c. a copy of the revocation letter;
- d. the date the organization was incorporated. If the organization is an unincorporated association or a trust, the date on which it was formed should be indicated;
- e. a statement that, as a taxable entity, the organization should be reporting any income, employment and excise taxes for which it may be liable; and,

- f. a copy of any tax return that has been obtained and a statement that the originals have been obtained by the Employee Plans and Exempt Organizations (EP/EO) Division and forwarded to the appropriate service center for processing.

If no tax return has been obtained because the organization did not submit appropriate returns as requested by the EP/EO Division, or because the preparation of Form 1120 or Form 1041 is complex and requires the expertise of income tax examiners, a statement to that effect should be made along with a recommendation that the return be secured by the district Examination function.

In cases where contributions to the organization were formerly deductible as charitable contributions, the information submitted should also contain a statement that contributions to the organization are no longer deductible. In this event, the names and social security numbers or employer identification numbers (if available) of substantial contributors to the organization should be furnished to facilitate the Examination function's securing corporate or individual income tax returns to determine whether donors may be erroneously claiming charitable contribution deductions. The effective date after which contributions are no longer deductible as charitable contributions should also be included.

If the organization agrees with the proposed adverse action, either by assent or execution of a Form 6018, consent to proposed adverse action, or by failing to file a protest, the proposed adverse action becomes final in cases not subject to IRC 7428. In cases where IRC 7428 applies, a proposed final determination letter will be prepared. It will contain the following paragraph:

It is further determined that your failure to file a written appeal constitutes a failure to exhaust your available administrative remedies. However, if you decide to contest this determination in court, you must initiate a suit for a declaratory judgment in the United States Tax Court, the United States Court of Claims, or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment.

A final adverse determination letter will be issued by certified or registered mail in all IRC 501(c)(3) cases or IRC 7428 cases. Where a case is being protested, the same letter, without the above paragraph, should be prepared and forwarded along with the case file to the Appeals office.

Control documents and EO input vouchers on adverse letters will be submitted to the service center for processing when an agreed case is closed. Form 2363A, EO BMF Entity Voucher, should be submitted when the final determination has been made. The Chief, Technical Staff, will insure that the proper follow-up procedures for securing tax returns have been complied with. Where a case has been sent to the Appeals office, control documents and input vouchers should be prepared for IRC 7428 cases. In all other cases, they should be prepared when the case file has been returned to the district.

Form 4194, Cumulative List Action, will be prepared and forwarded to the National Office, attention: T:FP:P-1, concurrently with the mailing of the final adverse letter to the organization.

4. Procedures for Unagreed Cases

After the proposed revocation letter is issued to the organization, the file will be placed in suspense with the key District Technical Staff. No action will be taken by the Service for a period of 30 days unless the interests of the Government are in jeopardy. During the 30 day period, the organization has the opportunity to protest the proposed revocation. An organization may protest by submitting a statement of the facts, law and arguments in support of its continued exemption. In addition, the organization should indicate in its letter of protest whether it desires to have a conference in the Appeals office to discuss the issues. In some instances, the conference may be held at a district office, if more convenient to both parties.

If the final revocation is sustained after an appeal, the Appeals office will forward Form 5666 to the Examination function in the appropriate district. If the revocation is not sustained, the organization will continue to function as an exempt organization and the Form 5666 will be destroyed.

5. Application of IRC 7805(b) Relief

Where the relief provisions of IRC 7805(b) have been requested by the organization or are being recommended by the Service, the case must be forwarded to the National Office prior to issuing the final determination letter (see IRM 7(10)(12)6.3). Where the determination for revocation is made on the basis of National Office technical advice, the organization may not appeal the determination. In such cases, a final revocation letter will be sent to the organization.

If the organization does not request IRC 7805(b) relief and the key District Director believes that it is appropriate, the case will be forwarded to the National Office if the adverse issue has been agreed upon. Referral should include a memorandum setting forth the reasons the key District Director believes that IRC 7805(b) relief should be granted. An organization requesting such relief, even if the key District Director is not recommending it, should prepare a letter detailing its reasons for such relief and a proposed effective date. When the case is referred, the key District Director will include a discussion of the effective date asked for by the organization if that date is different from the one recommended by the key District Director or if IRC 7805(b) relief is not recommended. If there are doubts or other problems arise in recommending an appropriate date to which a revocation letter should be retroactively applied, the examiner should identify and explain whatever alternatives may exist and lay a basis for the selection of an effective date. The examiner should then inform the organization that the request for IRC 7805(b) relief is being referred to the National Office and indicate the recommended effective date of the revocation, where one has been proposed.

The referred case should contain Form 6018 and a copy of the letter the key District Director has sent to the organization proposing to revoke its exemption letter. The district office case file should also contain definite information about when the action began or occurred that formed the basis for the recommendation of an adverse action.